



# The Federal Report

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

## The Month in Washington: November, 2008

Following his historic election, President-elect Barack Obama began one of the fastest and most active transitions by naming personnel and dominating the news with proposals. As the Bush Administration continues to try to manage the implementation of the Troubled Asset Relief Program (TARP), a growing number of Members of Congress have begun to question whether there is an effective plan to stabilize the U.S. economy. During Capitol Hill hearings, members of the Administration have been questioned regarding their apparent lack of direction and for their failure to dedicate any of the relief funding to provide mortgage relief. Congressional leaders have made it clear that they believe that a plan must be put in place to curb mortgage foreclosures. A lame duck session of Congress provided a stage for the American automakers to make their argument for Federal assistance; however, Congress left town asking the leaders of the Big 3 to return with a viable plan. The optimism that surrounds the incoming Administration continues to be tempered by the seriousness of the ongoing economic uncertainty.

### Issues and Events

#### Obama Wastes No Time on Economic Personnel, Plans

The transition team of President-elect Barack Obama named many key players for the economic team. Given the gravity of the economic slowdown, the typical time-table of nominations that trickle in from Election Day to late December was substantially accelerated. As ABC World News put it, Obama "may not yet be officially on the job, but he's on the case."

The top picks went to New York Fed Chairman Timothy Geithner for Treasury Secretary and Clinton era Treasury Secretary Larry Summers for head of the National Economic Council. Both men are well respected. Peter Orszag, currently of the Congressional Budget Office, moves across town to head the Office of Management and Budget. The Administration-in-waiting believes market conditions require strong action and incontrovertibly competent people to restore public confidence and staunch the fiscal bleeding.

Obama also announced the creation of the President's Economic Recovery Advisory Board, with former Federal Reserve Board Chairman Paul Volker as Chairman. Austan Goolsbee, a Chicago School economist and economic advisor to Obama during the campaign, will be the Board's staff director.

This group will provide oversight over the implementation of the stimulus plan intended for the general economy outlined by Obama. The plan under discussion involves \$700 billion to \$1 trillion in stimulus spending that will create 2.5 million jobs as a way to inject money into the sluggish economy. The idea is to place the plan forward now, start the discussion, and act quickly in January when the new Administration takes office.

Incoming Chief of Staff Rahm Emanuel has already met with Congressional Republicans as a sign of good faith and an offer to work together on the problems facing the country, saying afterwards that the new Administration will be open to any good idea, regardless of where it originates. Obama advisors are also in contact with Democratic Congressional leaders so that the economic program can be enacted with all possible speed. While Members spend time at home, policy staff in Washington are already talking details.

### **What Tom Daschle Means for Health Reform**

Former Senate Majority Leader Tom Daschle (D-SD) is slated to become Secretary of Health and Human Services (HHS) and as such will be the chief agent of an Obama Administration in health reform. Daschle possesses keen political skills and remains popular from his time in the Senate.

The selection sends several signals to Washington. Assigning a person of Daschle's gravity to HHS suggests that health reform remains a top priority despite calls by many – including those who do not believe in reform to begin with – that current economic conditions prohibit this costly government undertaking.

Naming Tom Daschle to HHS Secretary shows that the Obama Administration remains committed to healthcare reform, and that he understands the problem as primarily political, not technical. If Daschle accepts the position as widely accepted, it also means that he will be given wide authority to pursue reform and to make the political deals that are necessary to get the reform done.

### **Treasury Changes Course on Bailout**

Treasury Secretary Hank Paulson has spent much of November trying to explain his actions to a Congress that is rapidly growing impatient with the Administration's lack

of a clear plan to utilize funds provided by the Troubles Asset Relief Program (TARP) to stabilize our economy.

Government purchase of troubled assets was at first the entirety of the bailout plan until Congress added a portion allowing the government to buy stakes in troubled companies, thus infusing lenders with fresh capital. Now the initial concept has been almost completely abandoned and the government will focus the Troubled Asset Relief Program (TARP) on an approach involving ownership stakes in the companies themselves.

Paulson remained confident, saying that "I will never apologize for changing a strategy or an approach if the facts change." "This hasn't done the Treasury's credibility a world of good," said Alan Ruskin, chief international strategist at RBS Global Banking and Markets in New York. "Basically, they found that the market would applaud direct capital injections more readily than understanding the complexities of reverse auctions to buy assets, so it's a pragmatic choice."

The direct purchase approach is similar to that used for American Insurance Group (AIG). Although AIG continues to need more money, reports suggest that the case is considered a success thus far even as its cost grows from an initial \$85 billion to \$152 billion. Conversely, covering bad assets is an approach used in the latest bailout for Citigroup.

Members of Congress are beginning to lose patience with the initiative. House Financial Services Committee Chairman Barney Frank (D-MA) said in mid-November that the \$700 billion in bailout funds could be cut if Congress feels the recipients are misusing the money. Frank predicted that if Congress does not see bailout funds going for loans, "there's going to be a revolt," among lawmakers. "I don't want to see that happen," Frank added. The deeply unpopular bill cleared the House only after the entire bipartisan leadership made a second attempt, and added \$150 billion in extraneous funds to gain support.

On November 17, the House Financial Services Committee questioned Secretary Paulson over the perceived bait-and-switch in approving the bailout he touted. Panel members accused Paulson of neglecting oversight and poorly managing the funds. "You seem to be flying a \$700 billion plane by the seat of your pants," offered Congressman Gary Ackerman (D-NY). Critics have suggested that the change in fundamental strategy conveys policy confusion to the public. "Do we have a plan? Where are we going?" asked Congressman Paul Kanjorski (D-PA).

Congresswoman Maxine Waters (D-CA) sharply criticized Secretary Paulson for the Administration's failure to direct any of the TARP funding to stem the tide of home foreclosures. She accused him of ignoring the expressed intent of Congress and

underscored her belief that the failure of the U.S. housing market represents a fundamental cause of the current recession.

Senators Chuck Schumer (D-NY) and Bob Menendez (D-NJ) recently wrote to Paulson over concerns that the bailout funds have been misused: "These loans must not be used to acquire healthy banks, hoard in their coffers, or pay shareholder dividends," responding to criticism that as much as half of the \$250 billion allocated thus far would be used for non-lending purposes.

President – elect Obama and future members of his Administration appear committed to the bailout plan; to show anything else would cause the markets to completely discredit current action on the expectation that the rules would change in less than two months when new leadership comes to Washington. The political alliance that created the program, however, already shows enough fractures that Obama could have great latitude to make broad changes to the program when his team can call the shots.

### **California Congressional Delegation**

The election of Congressman Henry Waxman (D-CA) to chair the powerful Energy and Commerce Committee came as the biggest surprise of the post-election jockeying. Waxman replaces Congressman John Dingell (D-MI), the longest serving current House Democrat, as the leader of a committee with broad authority over healthcare, the pharmaceutical industry, energy, and other issues vitally important to CalPERS members. Waxman will also bring a Greener outlook with him from California compared to the perspective of industrial Michigan. His election was seen as part of the broader mood in the country for change.

Californian Congressman Dan Lungren (R-CA) challenged sitting House Minority Leader John Boehner (R-OH). Lungren did not make the challenge personal, instead insisting that competition would be good for the party, particularly in light of its continuing losing streak at the polls. Despite misgivings at the electoral drubbing, Boehner won easily. At the same meeting, Eric Cantor (R-VA) took the Minority Whip post and Mike Pence (R-IN) took the Chair of the House Republican Conference.

Other Californians assuming new responsibilities in the incoming Congress include Congressman Xavier Becerra (D-CA) who was elected Vice Chairman of the House Democratic Caucus and Congresswoman Barbara Lee (D-CA) who was elected Chair of the Congressional Black Caucus.

## **Related National and Industry News**

### **Lame, But Prudent, Session on Autos**

“Bailout fatigue” pushed an aid package for the faltering automobile industry into December as leaders recognized that there was no prospect for a successful vote on the issue in the current lame duck session. They will try again in early December, when the automakers are to return to Congress with plans that show how the money will be used to or wait for the 111<sup>th</sup> Congress that convenes in January, 2009.

After badly blundering the publicity of their appearance by arriving in private jets and insisting that company management was irreplaceably top-notch, the chieftains of the Big Three U.S. automakers were told on November 20 to devise their own plan and return in early December. “Until they show us the plan, we cannot show them the money,” House Speaker Nancy Pelosi (D-CA) said at a news conference with Senate Majority Leader Harry Reid (D-NV).

The Big Three came to ask for an urgent \$25 billion loan to keep them going until their existing \$25 billion taxpayer grant could arrive early next year. The corporate leaders asked to tap the pool of \$700 billion in bailout funds assigned to the Troubled Asset Relief Program (TARP) or to get the \$25 billion – approved to help Detroit retool for more fuel efficient cars – earlier. In making their pitch to the Hill, where Members must still deal with voter anger over the souring bailout itself, the Big Three executives said that the credit crunch was the root of their problems.

Members of Congress were deeply skeptical. “We have little evidence that \$25 billion will do anything to promote long-term success,” said Senator Mike Enzi (R-WY), one of several Members who battered the executives at a hearing where the consensus opinion, repeatedly rejected by the carmakers, was that bad management and poor decisions had dug the hole that now required a Federal ladder. Senator Richard Shelby, top Republican on the Banking Committee, asked, “How is this money going to be used? Will it be used to improve their business model and product lines, or is this just life support?” Banking Chairman Chris Dodd (D-CT) said that the CEO’s “discomfort in coming to the Congress with hat in hand is only exceeded by the fact that they are seeking treatment for wounds that are to a large extent self-inflicted.”

The chief argument for automaker aid came from the left, ironically put forward by the CEO’s of the Big Three. General Motors Chairman Rick Wagoner said, “The societal costs [of failure] would be catastrophic – three million jobs lost within the first year, U.S. personal income reduced by \$150 billion and a government tax loss of more than \$156 billion over three years.” United Auto Workers President Ron Gettelfinger essentially agreed.

Thus, the mixture of Midwestern industrial interests mingled with labor concerns to move the Democratic leadership to craft a proposal. The plan on the table, and left there for lack of consensus, incorporated lessons learned from the bailout bill. It provides \$25 billion in aid and bans use of any funds to pay bonuses to employees earning more than \$200,000 annually; dividend payments would be forbidden as long as the taxpayers were owed money; and the companies taking money would submit to a Federal oversight board that could overrule the regular board's decisions. Republicans continue to press for bankruptcy protection as the best solution for the problem.

### **Election Wrap-Up**

Senator Barack Obama (D-IL) was elected to serve as the 44<sup>th</sup> President of the United States on November 4, 2008, by an electoral count of 364-173; the national popular vote, which has no bearing on electing the president but counts for claiming a mandate from the people, was 52% to 46% in Obama's favor.

The pursuit of a 60 vote majority by Senate Democrats moved a notch closer as incumbent Senator Ted Stevens (R-AK) conceded to his foe Anchorage Mayor Mark Begich. In his final floor speech, Stevens said, "I don't have any rear-view mirror, I look only forward. And I still see the day when I can remove the cloud that currently surrounds me. My motto has always been 'to hell with politics, just do what's right for Alaska.' And I've tried every day to live up to those words."

The Begich victory puts Democrats two seats away from a 60 vote coalition (including the two independents who vote and caucus with the Democrats). Even if an outright super majority does not come to pass, there are several moderate Republicans, such as Susan Collins and Olympia Snowe of Maine, who could be induced to vote with Democrats on crucial issues and thus break the threat of filibuster that has been used so often in recent Senate history to block legislation.

### **Nervous Voters Reject Market, OPEB Funding Plans**

Election Day proved a tough climate for ballot initiatives concerning pension investments as voters put a skeptical eye to the markets.

Utah voters declined the advice of the governor, legislature, and agencies involved and defeated a measure to allow the state treasurer to invest school money in venture capital and private equity. The proposal fell 56% to 43%. Local analysts blamed the defeat squarely on the timing of the vote, where stock market volatility spooked a wary electorate. In Montana, a measure to lift the ceiling on private company stock investments by the public plans to 25% failed by a three to one margin.

South Dakotans were asked to limit their state's involvement in short-selling (they refused) and apply delivery restrictions on short-sales (also rejected). Local papers said of the measure "there's no agreement on what this measure actually does" and it failed on a vote of 57% to 43%. In Louisiana, a proposal to invest funds for public employee health, life insurance, and other OPEB funds was defeated by a margin of 12%.

### **Working Group Agrees on OTC Derivatives**

The President's Working Group (PWG) issued a statement on OTC derivatives regulation on November 14 that sought to improve oversight of the market through transparency and centralization. The Federal Reserve, Securities and Exchange Commission (SEC), and the Commodities Futures Trading Commission (CFTC) issued a Memorandum of Understanding about joint regulation of the market. The regulatory parties also seek to establish a central counterparty clearing and pricing service for credit default swaps, the \$50 trillion market that underlies the recent market collapse. The PWG further clarified its policy objectives in making the changes as improving transparency, enhancing risk management, strengthening OTC derivative "infrastructure," and building better links among regulators.

### **Citigroup Gets Federal Aid**

On November 24, Citigroup received Federal assistance in the form of \$20 billion in direct capital and a Federal guarantee on up to \$305 billion in illiquid and possibly worthless "troubled" assets. Citi agreed to cut its dividend to 1¢ and restrict executive compensation.